



County of Los Angeles  
**CHIEF ADMINISTRATIVE OFFICE**

713 KENNETH HAHN HALL OF ADMINISTRATION • LOS ANGELES, CALIFORNIA 90012  
(213) 974-1101  
<http://cao.co.la.ca.us>

DAVID E. JANSSEN  
Chief Administrative Officer

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January 10, 2005

To: Supervisor Gloria Molina, Chair  
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Supervisor Don Knabe  
Supervisor Michael D. Antonovich

From: David E. Janssen  
Chief Administrative Officer

**SACRAMENTO UPDATE -- GOVERNOR'S PROPOSED FY 2005-06 BUDGET**

Today, Governor Schwarzenegger released his \$111.7 billion Proposed Budget (\$85.7 billion General Fund) for FY 2005-06, which his Administration indicates will close a \$9.1 billion budget gap, including a \$500 million budget reserve, in the budget year. In his cover letter and in his remarks at the press conference when the Budget was released, the Governor stressed the need to achieve structural reforms in the State budget in order to bring spending into line with revenues. While the Proposed Budget anticipates some \$409 million from "Revenue Issues," it explicitly rejects increasing taxes as part of the budget solution.

According to the Governor, unless the laws and constitutional provisions that put much of State spending on auto-pilot are changed, the State will "continue to face huge deficits – year after year after year." In the meantime, the Proposed Budget, like previous budgets, closes the budget gap by relying on borrowing and one-time budget solutions that result in the gap reemerging in future years. While no estimate is included in the Budget, the Legislative Analyst has estimated that the FY 2006-07 budget year deficit would be over \$10 billion, absent permanent spending reductions or revenues in the budget year.

Among the structural reforms identified by the Administration as necessary to bring State spending under control, are a number of controversial proposals that will be submitted to the Legislature shortly, including elimination of the maintenance factor in the Proposition 98 guarantee for K-14 school funding, elimination of the ability to suspend the Proposition 42 transportation funding (but not until after a two-year suspension), a prohibition against internal borrowing from other State funds, and in the

event of a projected budget imbalance, imposition of automatic, across-the-board spending reductions by the Controller if the Legislature is unable to act either within 45 days after the Governor calls a special session to address a mid-year imbalance, or within 30 days of the June 15 deadline for adoption of a new budget.

**The Proposed Budget would suspend State mandates, confronting the County with the choice of either funding currently mandated services (with no promise of eventual reimbursement of over \$60 million in costs) or suspending the services until State funding is resumed. In addition, as part of a debt consolidation plan under its proposed structural reform, the Administration is proposing to stretch repayment for currently deferred mandates for up to 15 years instead of the current statutory requirement of 5 years. The County currently has over \$200 million in deferred reimbursements.**

The Budget's key economic indicators – California personal income, taxable sales and consumer price index – are somewhat more optimistic than the assumptions of the Legislative Analyst's Office (LAO) November 2004 Fiscal Outlook resulting in over \$1 billion of additional revenue beyond what the LAO had projected. The LAO will release its analysis of the Governor's Proposal in February, at which point there will be a non-partisan evaluation of the economic assumptions of the revenue forecast and the spending projections that, together, determine the size of the budget gap.

### ***THE BUDGET GAP***

The \$9.1 billion gap includes a \$1.7 billion operating deficit in the current year, a \$5.2 billion gap between expenditures and revenues in the budget year, the loss of \$2 billion of one-time funding from the Economic Recovery Bonds, and \$170 million of other adjustments.

### ***THE BUDGET SOLUTION***

The Governor proposes to close the \$9.1 billion budget gap as follows:

- 63 percent (\$5.7 billion) through cuts and savings, including \$2.2 from K-14 education funding, \$1.1 billion from health and human services and \$928 million from general government;
- 33 percent (\$3 billion) from loans including \$1.7 billion in Economic Recovery Bond proceeds and \$1.3 billion from suspending the Proposition 42 transfer of the sales tax on gasoline to transportation projects;
- 4 percent (\$409 million) from unspecified revenue enhancements.

An estimated \$2.0 billion of Economic Recovery Bonds would not be sold at this time, but presumably would be used to finance the FY 2006-07 Budget. The Proposed Budget provides for a \$500 million reserve.

### ***BUDGET HIGHLIGHTS***

Based on a preliminary analysis of the "Governor's Budget Summary," the following proposals are most likely to impact or to be of interest to the County.

#### **General Government**

**SB 90 State Mandated Local Programs.** Since deferral of local government reimbursement is no longer an option because of Proposition 1-A, the Administration is suspending them entirely with no obligation to reimburse local governments that maintain the programs. In addition, the Administration proposes repayment of currently deferred amounts over a period of up to 15 years, rather than 5 years. The State currently owes the County over \$200 million.

**Property Tax Grant Program.** Proposes a \$5.7 million reduction statewide to this program. This action will result in a 10.5% reduction which could result in an estimated \$1.4 million loss to the County.

**Los Angeles County Detection and Trapping.** Includes an augmentation of \$760,000 for full year funding of staff for containment and eradication of fruit flies and pests.

**California State Library.** Proposes \$71.6 million, a \$3.3 million General Fund reduction from FY 2004-05. Reductions include \$2.2 million from the Public Library Foundation program, \$.83 million from the Library Development Program, and \$.27 million from the English Acquisition Program, for a total \$3.3 million General Fund reduction in local assistance. According to the County Librarian, the County's share of the reduction will be \$220,000.

#### **Health**

**Medi-Cal.** Expenditures are projected to be \$34.1 billion in FY 2005-06, including \$12.9 billion General Fund, an increase of \$981.7 million, or 8.2 percent.

**Medi-Cal Program Redesign.** Recommends \$12.3 million net General Fund savings from redesigning Medi-Cal including:

- a projected savings of \$24.8 million from capping the Medi-Cal dental benefit package at \$1,000 annually for adults.

- \$3.4 million to expand use of managed care for families and children in up to 13 additional counties and shift aged, blind and disabled participants into managed care plans.
- \$6.8 million to establish monthly premiums for individuals with incomes above the poverty level and for seniors and persons with disabilities above the SSI/SSP level.
- \$.98 million to streamline enrollment for children through processing by the Single Point of Entry vendor instead of counties.
- \$.61 million for County performance standards monitoring.

The Proposed Budget indicates that the Administration is working on an approach to respond to Federal criticism of the way safety net hospitals are financed under Medi-Cal but provides no specifics on the plan.

#### **Expanding Health Insurance Coverage for Children.**

- Proposes \$5.9 million in General Fund and \$8.6 million in matching Federal funds to re-establish application assistance fees.
- Includes \$5.6 million to establish Medi-Cal/Healthy Families Bridge Performance Standards to ensure that counties comply with the requirement to forward applications to the Healthy Families Program for children who are no longer eligible for Medi-Cal.
- Provides \$.49 million in FY 2004-05 and \$.91 million in FY 2005-06 from the First 5 California Children and Families Commission as State share to obtain Federal financial participation for technical assistance to counties providing local, low-cost health coverage to children not eligible for Medi-Cal or Healthy Families.
- Proposes to update the joint Medi-Cal/Healthy Families application form to make it easier for parents to complete, including an authorization form to release information to certified application assistants.

**California Obesity Initiative.** Includes \$6 million General Fund for a comprehensive obesity prevention program to promote healthy eating, regular physical activity, and responsible choices by individuals.

**Prescription Drugs for the Uninsured.** Includes \$4 million General Fund to implement the California Rx (Cal Rx) Program to provide prescription drugs for an estimated 4 million Californians with ongoing prescription drug needs.

**Streamlining Hospital Construction Review.** The Administration will sponsor legislation to allow hospitals to contract with an independent plan reviewer for large hospital construction projects.

**Public Health.** State expenditures for all public health programs and State administration total \$3.5 billion, an increase of \$53.5 million, or 8.2 percent.

**Newborn Screening Program Expansion.** Includes \$15 million from the Genetic Disease Testing Fund to expand newborn screening for an additional 37 treatable genetic diseases.

**Bioterrorism Prevention and Preparedness.** Includes \$108.6 million in Federal funds to support California's public health system's capacity to respond to bioterrorism, outbreaks of infectious diseases, and other public health threats.

**Children's Medical Services.** Includes \$243.7 million, an increase of \$22.7 million above the FY 2004-05 Budget.

**HIV/AIDS Treatment and Prevention.** Includes approximately \$381 million for the HIV/AIDS Treatment and Prevention Program administered by the Office of AIDS, an increase of \$20.1 million.

**Additional Medi-Cal Pharmacy Rebates.** Assumes \$20 million in General Fund savings in recently negotiated rebates for heartburn medication.

**Maximize Federal Funds for Prenatal Care.** Proposes \$191 million in General Fund savings reflecting accessing Federal funding for prenatal care provided in Medi-Cal. An additional \$51 million General Fund savings is proposed for the Access for Infants and Mothers (AIM) Program.

**AIDS Drug Assistance Program Rebates.** Proposes \$8.8 million in General Fund savings related to higher-than-anticipated collections of drug manufacturer rebates.

**Office of Bi-national Border Health.** Eliminates \$694,000 in General Fund support; \$500,000 in Federal funds remains to support the office's mission.

**Addressing California's Nursing Shortage.** Proposes meeting the forecast demand for more registered nurses between 2000 and 2010 by increasing the number of persons educated in California Community Colleges, institutions of higher education, and nontraditional education environments using Workforce Investment Act (WIA) funds. In FY 2004-05 and FY 2005-06 the Administration proposes allocating a combined total of \$35.6 million in WIA funds for the training of nurses and other health care workers.

## **Mental Health**

**Proposition 63 - Mental Health Services Act (MHSA).** The State Department of Mental Health will present a detailed resource needs assessment for implementation of the MHSA for both FY 2004-05 and FY 2005-06 in the May Revision.

**Community Mental Health Services - Early and Periodic Screening, Diagnosis, and Treatment Program (EPSDT).** Of the \$1.8 billion included in the Governor's Budget for community mental health services, a net increase of \$86.3 million, \$801.2 million is budgeted for EPSDT, an increase of \$76.7 million to cover projected claims.

**Sexually Violent Predators (SVP).** Proposes a \$9.2 million General Fund savings for the State hospitals for FY 2005-06 by keeping pre-commitment SVPs in local custody until they are committed by the courts as SVPs, and by transferring existing pre-commitment SVPs in State hospitals to local custody.

**SVP Treatment Restructuring.** Proposes a \$6 million General Fund savings for the State Hospitals for FY 2005-06, growing to \$11 million in FY 2006-07, by restructuring supervision and treatment services provided by State hospitals to SVPs.

## **Social Services**

**CalWORKs Employment Services.** Maintains an augmentation of \$191.9 million for employment services provided in FY 2004-05 and FY 2005-06 but deletes the one-time legislative augmentation for CalWORKs employment services provided in FY 2004-05, for savings of \$50 million.

**CalWORKs Grants.** Proposes to save \$212.3 million in FY 2005-06, and annually thereafter, by reducing grants by 6.5 percent.

**CalWORKs Cost-of-Living Adjustment (COLA).** Proposes to save \$163.8 million in FY 2005-06 and thereafter by permanently eliminating the COLA.

**CalWORKs Work Requirements.** Proposes to save \$12 million because of the impact of the CalWORKs reforms enacted in FY 2004-05 which strengthened work requirements.

**CalWORKs Earned Income Disregard.** Proposes to save \$79.5 million in FY 2005-06 and \$109.3 million annually thereafter by reducing the earned income disregard from the current \$225 and 50 percent of the remaining earned income to \$200 and 40 percent of remaining income.

**CalWORKs Pay for Performance Proposal.** Proposes to save \$22.2 million in FY 2005-06 by implementing a new incentive system that bases a portion of the counties' single allocation for administration and employment services on specific outcomes of CalWORKs clients in each county.

**CalWORKs Child Care.** Proposes funding of \$461.5 million including savings of \$50.9 million associated with cases reaching the CalWORKs 60-month time limit. Also included is a budget reduction of \$62.6 million due to a proposed change in reimbursements.

**Adjustments to CalWORKs Employment Services and Administration Funding.** Proposes to save \$42.9 million by modifying the past practice of not adjusting current year funding when updated estimates would result in lower costs.

**Tribal Temporary Assistance for Needy Families (TANF) Expenditures.** Proposes to save \$5 million by reducing the amount of State funding provided to the tribal entities in FY 2004-05 to reflect an anticipated decline in programmatic expenditures.

**Statewide Fingerprint Imaging System.** Proposes \$8.0 million for maintenance and operation, a \$95,000 increase.

**Los Angeles Eligibility, Automated Determination, Evaluation and Reporting (LEADER) System.** Includes \$13.4 million for maintenance and operation of the LEADER System, which represents a \$1 million reduction for planning costs.

**Reduce State Participation in In-Home Supportive Services (IHSS).** Proposes to save \$152.1 million General Fund in FY 2005-06 and \$216.8 million thereafter, by reducing the maximum level of IHSS provider wages and benefits in which the State will participate from the current \$10.10 per hour to \$6.75 per hour.

**Suspend State Participation in Increased Contract Costs for IHSS.** Proposes to save \$42.7 million annually by maintaining State participation in wages and in health benefits at the level of funding in the 2004 Budget Act (12 counties negotiated contracts to increase IHSS service provider wages/benefits since the 2004 Budget Act).

**Foster Care.** Proposes \$2 billion for Child Welfare Services, including expanded implementation of a Standardized Safety Assessment System. Additionally, it proposes legislation to allow the State to pass on to counties a portion of future Federal penalties associated with non-compliance by California with the Federal Child and Family Services Review.

**Child Support Services.** Proposes \$194.1 million General Funds for local agency administrative costs, approximately the same level of funding provided in FY 2004-05.

**Federal Child Support Automation Penalty.** Proposes \$218 million State funding for payment of the Federal Fiscal Year (FFY) 2005 penalty and assumes that the Federal government will allow the State to defer payment of the FFY 2006 penalty until September 2006. This proposal will allow the State to continue operating the Child Support Program in FY 2005-06 without loss of the program's Federal share of funding or jeopardizing TANF funds. Completion of the new California Child Support Automation System is expected to be finalized and fully functional on a statewide basis in September 2008, as required by the Federal government.

**Naturalization Services.** Eliminates the program for a savings of \$1.5 million in FY 2005-06 and annually thereafter, noting that the State Department of Education provides similar services.

### **Justice and Public Safety**

**Juvenile Justice Crime Prevention Act.** Eliminates current year grant funding of \$100 million but shifts \$25 million to the Board of Corrections for negotiations with counties on assuming increased responsibility for a number of changes in the juvenile justice system the Administration is proposing. The County currently receives \$28 million in grants but would not be impacted until the next budget year because the program is funded a year in advance.

**Probation TANF Funding.** Provided \$201.4 million in Federal TANF funding for juvenile probation services. TANF funds had been deleted from this program for the current year.

**Youthful Offenders Parole Responsibility.** Due to a projected decline in California Youth Authority (CYA) parolees, the Administration is proposing to shift supervisory responsibility from the CYA to counties. The parole population, which is projected to be 3,790 by June 30, 2005, is expected to decrease by 340 cases to 3,450 by June 30, 2006. Details of the plan and associated funding needs will be in the May Revision.

### **Transportation**

**Proposition 42.** Proposes to suspend for two years the transfer of \$1.3 billion in sales tax revenue for transportation to be repaid over 15 years, including \$253 million to cities and counties that will impact street repaving in the unincorporated areas.

### **Natural Resources and Environmental Protection**

**Natural Resources.** Includes \$164.7 million in local assistance funding from Proposition 50 and Proposition 13 bond funds to fund projects that improve water quality.



**Environmental Protection.** Increases appropriations for the Air Resources Board by \$69.6 million funds, including \$30.5 million for the full-year funding for the Carl Moyer Program authorized in FY 2004-05, and a \$25 million increase to provide additional mobile source emissions mitigation grants to local air districts. Reduces overall funding to the State Water Resources Control Board by \$305 million with most of the decrease due to less bond money being available in 2005-06.

### **Judicial**

**Trial Court Funding.** Increases funding by \$220.4 million to \$2.7 billion, due primarily to the restoration of a one-time reduction, a baseline budget adjustment and a growth factor augmentation. In addition, there is a proposed transfer of \$14 million from Judicial to Trial Court funding for trial court operations. We will continue to keep you advised.

DEJ:GK  
MAL:JF:JR:ib

c:     Executive Officer, Board of Supervisors  
         County Counsel  
         Local 660  
         All Department Heads  
         Legislative Strategist  
         Coalition of County Unions  
         California Contract Cities Association  
         Independent Cities Association  
         League of California Cities  
         City Managers Associations  
         Buddy Program Participants